IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF IDAHO

IN RE	)	
	)	
JACK KENNETH MIRTH and RUTH GEORGE ANN MIRTH,	)	**Case No. 98-20165**
	)	
Debtors.	)	
_____	)	**MEMORANDUM OF DECISION**
	)	**AND ORDER**
KISS ENTERPRISES, INC., and BYRON LEWIS,	)	
	)	
Plaintiffs,	)	**Adversary No. 98-6241**
	)	
v.	)	
	)	
JACK KENNETH MIRTH and RUTH GEORGE ANN MIRTH,	)	
	)	
Defendants.	)	
_____	)	

HONORABLE TERRY L. MYERS, U.S. BANKRUPTCY JUDGE

Thomas E. Cooke, Priest River, Idaho, for the Plaintiffs.

Jack and Ruth Mirth, Cocolalla, Idaho, Defendants pro se.

Currently before the Court are the Plaintiffs' Motion for Summary Judgment and its "Motion for Entry of Default." The Court denies Plaintiffs' Motion for Entry of Default, but grants their Motion for Summary Judgment.

BACKGROUND

Jack and Ruth Mirth filed a petition for relief under chapter 13 on March 6, 1998. The case was converted to chapter 7 on August 10, 1998. The Plaintiffs filed a complaint for nondischargeability on September 10, 1998.

In their complaint, the Plaintiffs claim the Mirths through their business, NorthWood[1], held certain funds for the benefit of the Plaintiffs and did not pay the funds to them. Plaintiffs allege that this conduct results in a nondischargeable debt owed to them.

NorthWood removed timber from the Plaintiffs' land under contract. The timber was sold, and rather than distribute the proceeds of sale directly to the Plaintiffs, NorthWood held the funds. The Plaintiffs allege the Mirths represented that the funds would be invested in marketable securities through

[1] Plaintiff alleges that the Mirths did business as "NorthWood Enterprises" and as "NorthWood Consulting Group," and that both were controlled by the Mirths and were not separate legal entities. These allegations have not been contested. For that reason, and as it is the Mirths' conduct that is at issue in this § 523 litigation, identifying which entity actually contracted with the Plaintiffs is irrelevant. Reference is simply made to "NorthWood."

NorthWood on behalf of the Plaintiffs, in Plaintiff KISS Enterprises' name. The Mirths contend in their Answer that the Plaintiffs specifically instructed NorthWood not to put the funds in the name of either Plaintiff, so that they could avoid paying income tax on the funds.

The Plaintiffs' Complaint alleges in part:

> 8. That in lieu of paying the logging proceeds to Plaintiffs, Defendants, [the Mirths], represented that they would invest the same in the Plaintiffs' behalf in various marketable securities, which securities were to be acquired in the name of KISS Enterprises, Inc. That the total funds which Defendants agreed to utilize in Plaintiffs' behalf were in the amount of ONE HUNDRED TWENTY-FOUR THOUSAND SIX HUNDRED SIXTY DOLLARS AND NINETY-SIX CENTS ($124,660.96).
>
> 9. That Defendants failed to purchase said securities in Plaintiffs' names, but instead through stealth and fraud purchased such securities in their own names, and subsequently sold and liquidated the same, and embezzled the proceeds.
>
> 10. That the foregoing act and conducts of the Defendants were accomplished jointly and severally, through false pretenses, false representations, fraud, and defalcation while acting in a fiduciary capacity, embezzlement or larceny. In the absence of the false representations made by the Defendants, Plaintiffs would not have (1) entered into the agreement with Defendants to permit them to invest their money, or (2) make payments to the Defendants pursuant to said agreements, and (3) would not have incurred the losses attributable to the Defendants.[2]

The Plaintiffs' motion for summary judgment is based on the complaint,

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[2] Complaint at para. 8-10, pp. 3-4.

affidavits[3], and on the Mirths' lack of response to requests for admission under Rule 7036 (incorporating Fed.R.Civ.P. 36). The admissions in their entirety are as follows:[4]

> 1. Admit that KISS ENTERPRISES, INC. is an Idaho Corporation in good standing, and that BYRON LEWIS is a private individual, and the sole stockholder, officer, and director of said Corporation.
>
> 2. Admit that the JACK KENNETH MIRTH and RUTH GEORGE ANN MIRTH, in 1994, were either doing business in an unincorporated fashion under the firm name of NorthWood Consulting Group, or had incorporated under said name, and that if incorporated, Defendants JACK KENNETH MIRTH and RUTH GEORGE ANN MIRTH were the sole stockholders, officers, and directors, of said Corporation.
>
> 3. Admit that in 1994, either JACK KENNETH MIRTH and RUTH GEORGE ANN MIRTH, d/b/a NorthWood Consulting Group or NorthWood Consulting Group, Inc. logged and removed timber from Plaintiffs' lands situated in Bonner County, and sold the same and received funds therefrom in Plaintiffs' behalf.
>
> 4. Admit that in lieu of paying the logging proceeds to Plaintiffs herein said Defendants individually, or if incorporated, their Corporation represented that they would invest the same in Plaintiffs' behalf in various marketable securities, which securities were to be acquired in the name of KISS ENTERPRISES, INC., and that the total funds which [the Mirths] agreed to utilize in Plaintiffs' behalf in the said manner were in the amount of ONE HUNDRED TWENTY-FOUR THOUSAND SIX HUNDRED

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[3] The affidavits relate to the service of and lack of response to the Plaintiff's requests for admissions, and to the total amount of the debt claimed due.

[4] The Plaintiffs' Request for Admissions is quoted here verbatim.

SIXTY DOLLARS AND NINETY-SIX CENTS ($124,660.96).

5. Admit that said Defendants failed to purchase said securities in the name of KISS ENTERPRISES, INC. and/or BYRON LEWIS, but, instead, purchased said securities in their own names or in the name of a corporate enterprise which was solely owned and controlled by Defendants.

6. Admit that in 1995 Plaintiffs' requested transfer of the marketable securities which Defendants or one of Defendants' corporations had allegedly purchased for them be transferred to them, and that said Defendants agreed to do so.

7. Admit that said securities were never in fact transferred to Plaintiffs, but were liquidated by Defendants, or a corporation controlled by Defendants, and that the proceeds thereof were either embezzled or otherwise converted to Defendants' own use.

8. Admit that the proceeds which are the subject of the preceding Request for Admission were not contained within any bank account of the Defendants or in any corporation under the Defendants' control at the time Defendants and their corporations were placed within a State Court Receivership.

The Mirths, as noted, did not respond to the requests. They have also failed to file any affidavits or other materials in opposition to the Plaintiffs' Motion for Summary Judgment, despite expressly being allowed an additional opportunity to do so after appearing before the Court on March 30.[5]

DISCUSSION

Summary judgment is appropriate under Fed.R.Civ.P. 56, incorporated

[5] It is this failure of the Mirths to respond after being specifically provided the opportunity to do so that apparently leads to the Plaintiff's "motion for entry of default." If the motion seeks default under Rule 55, this relief is unavailable since the Defendants did in fact file an Answer.

in this case by Rule 7056, "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact that the moving party is entitled to a judgment as a matter of law." Fed.R.Civ.P. 56(c).

> [A] party seeking summary judgment always bears the initial responsibility of informing the . . . court of the basis for its motion, and identifying those portions of 'the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any,' which it believes demonstrate the absence of a genuine issue of material fact.

Celotex Corporation v. Catrett, 477 U.S. 317, 323 (1986).

Once the moving party meets its "initial burden to show the absence of a material and triable issue of fact; the burden then moves to the opposing party, who must present significant probative evidence tending to support its claim or defense." *Aubrey v. Thomas (In re Aubrey)*, 111 B.R. 268, 272 (9th Cir. BAP 1990) (quoting *Richards v. Neilsen Freight Lines*, 810 F.2d 898, 902 (9th Cir. 1987)). In this regard Fed.R.Civ.P. 56(e) provides:

> **(e) Form of Affidavits; Further Testimony; Defense Required.** Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or served therewith. The court may permit affidavits to be supplemented or opposed by depositions, answers to interrogatories, or further affidavits. <u>When a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest on the mere allegations or denials of the adverse party's pleading, but the</u>

> adverse party's response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If the adverse party does not so respond, summary judgment, if appropriate, shall be entered against the adverse party.

(Emphasis supplied).

1. Motion for Entry of Default

Based on the language of Rule 56(e), therefore, summary judgment may be entered for the Plaintiffs "if appropriate." Rule 56(e) does not alter the proponent's burden to establish a lack of genuine issue of material fact. *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 159-60 (1970). The phrase "if appropriate" requires the Court to evaluate all the allegations and submissions of the moving party. The Ninth Circuit Court of Appeals has "repeatedly held that it is error to grant a motion for summary judgment simply because the opponent failed to oppose [it]." *North Slope Borough v. Rogstad*, 126 F.3d 1224, 1227 (9th Cir. 1997). The Court will deny the Plaintiffs' "motion for default" filed as a result of the Mirths' failure to submit a response, as such a motion is not contemplated under the summary judgment rules. Accordingly, the motion for summary judgment must be reviewed on the merits and the record.

2. Summary Judgment on the Claims of Nondischargeability

The Plaintiffs allege three separate bases for nondischargeability of the debt: § 523(a)(2)(A) , (a)(4) and (a)(6).

Summary judgment based on the fiduciary claims under § 523(a)(4), and on

§523(a)(6), will be denied. The Plaintiffs have not alleged the prerequisite trust relationship with the Mirths, and therefore have not sufficiently supported a claim for fiduciary fraud or defalcation under § 523(a)(4). *See, e.g., Lewis v. Scott (In re Lewis)*, 97 F.3d 1182, 1185 (9th Cir. 1996). The Plaintiffs also have made no allegation that the Mirths had the requisite intent to harm required in actions under § 523(a)(6) for willful and malicious injury. *Kawaauhau v. Geiger*, 523 U.S. 57 (1998); *Aldrich v. Belmore (In re Belmore)*, 226 B.R. 433, 98.4 I.B.C.R. 102 (Bankr.D.Idaho 1998). Consequently, the Plaintiffs are not entitled to judgment as a matter of law under the fiduciary portions of § 523(a)(4), or under § 523(a)(6).

The Court will review the motion for summary judgment on the causes asserted under § 523(a)(2)(A), and under § 523(a)(4) as to larceny or embezzlement, which sections provide:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt --
>
> . . .
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by --
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;
>
> . . .

> (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;
> . . .

The prima facie case under § 523(a)(2)(A) is the same for false representations and actual fraud. *Compare Tallant v. Kaufman (In re Tallant)*, 218 B.R. 58, 64 (9th Cir. BAP 1998) *with Apte v. Japra (In re Apte)*, 96 F.3d 1319, 1322 (9th Cir. 1996). A creditor must prove by a preponderance of the evidence:

> (1) that the debtor made a representation; (2) the debtor knew at the time the representation was false; (3) the debtor made the representation with the intention and purpose of deceiving the creditor; (4) the creditor relied on the representation; and (5) the creditor sustained damage as the proximate result of the representation.

Tallant, 218 B.R. at 64 (*quoting Apte*, 96 F.3d at 1322 (citations omitted)); *see also American Express v. Hashemi (In re Hashemi)*, 104 F.3d 1122, 1125 (9th Cir. 1996), cert. denied, 520 U.S. 1230 (1997).

The standard for § 523(a)(4) is also well established:

> For § 523(a)(4) purposes, larceny is proven if the debtor has wrongfully and with fraudulent intent taken property from its owner. The three elements of embezzlement in the nondischargeability context are: (1) property rightfully in the possession of a non-owner; (2) non-owner's appropriation of the property to a use other than it was entrusted, and; (3) circumstances indicating fraud.

Dawson v. Kipling (In re Baugh), 97.2 I.B.C.R. 51, 55 (Bankr.D. Idaho 1997) (quotation and citations omitted). "Circumstances indicating fraud" means

"such circumstances that would indicate the presence of fraud or that [the debtor] acted with fraudulent intent." *In re Petersen*, 94 I.B.C.R. 223, 224 (Bankr.D. Idaho 1994).

Plaintiff's Complaint sufficiently sets forth a claim for relief under these authorities. The Mirths thereafter responded with the following specific factual averments in their answer.[6]

> There was no stealth or fraud involved. Defendants were trying at all times to accommodate BYRON LEWIS' specific request NOT to put the funds in either his name or KISS' name. BYRON LEWIS was an employee of NorthWood; he had full access to the company's records; and he knew exactly what was going on. Further, BYRON LEWIS was able to talk with NorthWood's accountant daily. There were no secrets.
>
> Further, Defendant JACK MIRTH had numerous conversations with BYRON that this arrangement made him very nervous and that he was not comfortable with it. Further, this arrangement has proved to be very costly to NorthWood Enterprises itself in its tax liability, despite the assurance from the accountant at that time (and upon which NorthWood had relied) that the funds could be handled in this way without problem.
>
> At some point, both MIRTH and LEWISES have had conversations with accountant JIM McCALL, who did tax work with both NorthWood and KISS/Lewis about this arrangement. BYRON and JIM McCALL discussed at length the possibilities of transferring the funds to KISS/LEWIS without severe tax liabilities. However, before anything was done, NorthWood was thrown into receivership and the company accounts were frozen to settle the lawsuit which had caused the receivership. Plaintiff Byron, as an employee of NorthWood, was also well aware of the

[6] The answer was signed by the Mirths.

lawsuit.

> 10. Defendants deny the allegations contained in Paragraph 10 of Plaintiffs' Complaint, stating again that there was no fraud, no deception, and no embezzlement involved on the part of [the Mirths]. Further, if there was misinformation, then it was given to Mirths/NorthWood/ and Lewises, equally.

These allegations controvert the allegations made in the Complaint. This, however, is not the end of the inquiry.

By failing to respond to Plaintiffs' request for admissions, the Defendants have thereby admitted those factual assertions for the purposes of Plaintiffs' Motion for Summary Judgment. [7] The factual matters thus admitted by the Defendants support entry of summary judgment. The Rule 7056 motion put the Mirths' to a burden of response. This was communicated to them at hearing. Yet they have failed to submit anything regarding the admissions, or the motion for summary judgment based thereupon. As noted above, Rule 56(e) demands that a party not rest solely on the averments of its pleadings when a motion for summary judgment has been made and properly supported. That is all the Defendants here have done. The Court finds that the record establishes no genuine issue of material fact which impedes the entry of a judgment of nondischargeability under §523(a)(2) and (4). The

[7] These admissions supersede the contrary allegations in the answer and, unless set aside on proper motion, are binding for purposes of the Plaintiffs' Motion for Summary Judgment. Rule 7036.

amount of the nondischargeable debt is $170,668.00 as established

by affidavit.[8]

CONCLUSION AND ORDER

The Court concludes, after evaluating the entirety of the submissions, that there is no genuine issue of material fact and that summary judgment is appropriate under Rule 56 upon the causes of action alleged under § 523(a)(2)(A) and under the larceny and embezzlement provisions of § 523(a)(4). The motion for summary judgment under other provisions of § 523(a) is denied, as is the Motion for Default. Counsel for Plaintiff shall submit a form of judgment in accord herewith.

DATED this 19th day of August, 1999.

[8] This amount is higher than that set forth in the admissions, but was not challenged by Defendants.